

Date: October 21, 1983

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Parts 330 and 337

FEDERAL HOME LOAN BANK BOARD

12 CFR Part 564

Brokered Deposits

AGENCIES: Federal Deposit Insurance Corporation and Federal Home Loan Bank Board.

ACTION: Advance Notice of Proposed Rulemaking.

SUMMARY: The Federal Deposit Insurance Corporation ("FDIC") and the Federal Home Loan Bank Board ("Board") (as operating head of the Federal Savings and Loan Insurance Corporation) ("FSLIC") are interested in receiving comments on certain deposit-placement activities in the depository institutions industry. The FDIC and the Board are concerned that a growing dollar amount of brokered and brokered-type deposits is being placed in fully insured accounts at FDIC- or FSLIC-insured institutions ("insured institutions") without an adequate analysis of the managerial strength and financial stability of the insured institutions. The concern is that this lack of analysis facilitates a flow of funds into financially unstable or managerially poor depository institutions. The FDIC and the Board are seeking comment on the extent to which these practices exist and on whether or how to deal with these practices through either limiting the insurance coverage afforded in connection with these deposits or restricting the receipt of such funds by insured institutions.

Additionally, both agencies suspect that the multiple insurance coverage afforded in relation to pension and other custodial deposits also fails to encourage market and institution analyses in the placement of these deposits. Currently, the regulations of both the FDIC and the FSLIC provide that each beneficial owner of such accounts is insured up to \$100,000. The Advance Notice also seeks comments regarding whether insurance on these accounts should be limited.

DATE: Comments must be received by November 28, 1983.

ADDRESSES: Comments should be directed to:

Hoyle L. Robinson, Executive Secretary, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429. Comments may be delivered to Room 6108 on weekdays between 8:30 a.m. and 5:30 p.m.

Director, Information Services Section, Office of the Secretariat, Federal Home Loan Bank Board, 1700 G Street, N.W., Washington, D.C. 20552. Comments will be publicly available at this address.

FOR FURTHER INFORMATION CONTACT: Joseph A. DiNuzzo, Senior Attorney, Legal Division, (202) 389-4171, Room 4126B, 550 17th Street, N.W., Washington, D.C. 20429, Federal Deposit Insurance Corporation; or Robert H. Ledig, Attorney, (202) 377-7057, Office of General Counsel, 1700 G Street, N.W., Washington, D.C. 20552, Federal Home Loan Bank Board.

SUPPLEMENTARY INFORMATION: The FDIC and the Board are concerned that the increased activity of deposit brokers and the emergence of innovative arrangements for the placement of deposits may disrupt market discipline by eliminating the need for risk-sharing by large depositors. These arrangements facilitate the placement of deposits with insured institutions within the insured amount regardless of the institutions' lending practices and financial soundness. Examples of existing brokering and brokering-type activities are as follows:

(1) Simple Brokering. The straight brokering of deposits to insured institutions operates in two basic ways. The money broker, acting on its own or at the request of an institution or institutions, solicits deposits from its customers. Under the first method, the interested customer sends funds directly to the institution which has been given prior notice by the broker of the impending purchase. Under the second method, the broker itself transfers the customer's funds to the institution and has the deposit registered at the institution in its name as nominee or agent for the customer. In turn, the broker maintains records reflecting the ownership interest of each customer in the deposit. According to current FDIC and FSLIC regulations, the broker's customers would each be insured on an individual basis under either brokering method. Section 330.2(a) of the FDIC's regulations and section 564.3(a) of the FSLIC's regulations provide that deposits placed by an individual at an insured institution are insured up to \$100,000. 12 CFR 330.2(a), 564.3(a). Sections 330.2(b) and 564.2(b) provide that deposits placed by an agent or nominee on behalf of an individual are insured as funds of the individual to \$100,000 in the aggregate with any other deposits maintained by that same individual in his or her own capacity at the same institution. 12 CFR 330.2(a), 564.3(b). In order for this insurance coverage to be provided, however, the records of the institution must indicate that the deposits are being held in an agency capacity and the records of either the institution or the agent must indicate the ownership interest of the principal(s). 12 CFR 330.1, 564.2(b).

(2) CD Participations. Some brokers engage in the practice of "participating" certificates of deposit to their customers. Under this arrangement a broker-dealer purchases a certificate of deposit issued by an insured institution and sells interests in it to customers. Upon sale of the participations in the deposit to its customers, the broker so informs the issuing institution and requests that the deposit be registered in its own name as nominee for others. The broker's records, in turn, reflect the ownership interest of each customer in the deposit. A CD participation program results in a "flow-through" of insurance coverage to each owner of the deposit. The ownership interest of each participant in the deposit is added to the individually owned deposits held by the participant at the same institution and the total is insured to a maximum of \$100,000, provided the proper recordkeeping requirements are maintained. 12 CFR 330.2(b), 330.1(b), 564.3(b) & 564.2(b).

(3) Deposit-Listing Services. Deposit-listing services have been formed to facilitate the placing of deposits with insured institutions. Institutions call the listing service and state the quantities, rates and maturities of deposits they wish to offer. Purchasers phone the listing service to obtain information on available deposits. An agent of the institution delivers the bearer-form deposit certificate to the purchaser's custodial agent subject to receipt of payment and the proceeds are forwarded to the institution. The insurance coverage regulations applicable in a typical principal/agent situation apply in this context. Each customer is insured to \$100,000 per insured institution in which he or she has placed a deposit through the deposit-listing service. 12 CFR 330.2(b) & 564.3(b). For purposes of determining insurance coverage per institution, this amount includes any other deposits owned by the customer in the same capacity at each of the institutions.

The FDIC and the Board are concerned that the above-described deposit-placement practices enable virtually all institutions to attract large volumes of funds from outside their natural market area irrespective of the institutions' managerial and financial characteristics. The ability to obtain de facto one-hundred-percent deposit insurance through the parcelling of funds eliminates the need for the depositor to analyze institutions' likelihood of continued financial viability. The availability of these funds to all institutions, irrespective of financial and managerial soundness, reduces market discipline. Although deposit brokering can provide a helpful source of liquidity to institutions, the practices described above make it possible for poorly-managed institutions to continue operating beyond the time at which natural market forces would have otherwise precipitated their failure. This impediment to natural market forces results in increased costs to the FDIC and the FSLIC in the form of either greater insurance payments or higher assistance expenditures if the institutions are subsequently closed because of insolvency.

The FDIC and the Board are also concerned about the statutory and regulatory provisions which afford multiple insurance coverage in connection with pension fund and other custodial deposits. Part 330 of the FDIC's regulations (12 CFR Part 330) and Part 564 of the FSLIC's regulations (12 CFR Part 564) provide, subject to recordkeeping and qualifying requirements, that deposits consisting of funds in which more than one individual has a beneficial interest are insured up to \$100,000 per beneficiary or owner. The most typical of these situations is the deposit account maintained by the trustee of a pension plan. There a \$1,000,000 deposit, for example, would be fully insured if ten participants in the plan each had an ascertainable interest in the deposited funds of \$100,000. As with the other types of deposits described above, the "flow-through" insurance coverage (i.e., the insurance "flows through" the trustee or agent to the beneficial owner(s) of the account) afforded in connection with trustee or custodial accounts is effective irrespective of the managerial or financial characteristics of the institution in question, so long as it is insured. Trustees and custodians normally limit deposits in each insured institution in order to keep within the insurance limits of FDIC and FSLIC coverage. The FDIC and the Board are concerned that this provision of multiple insurance undermines market discipline by relieving fiduciaries of their normal obligation to ascertain the soundness of an institution in which they place funds. It is not the FDIC's or Board's intention to shift the risk of loss to the beneficiaries of trustee or custodial accounts; rather, it is hoped that fiduciaries will be held to a higher standard of care in the placement of such funds.

In order to obtain comments on the matters set forth above, the FDIC and the Board are posing the following questions. Those commenting are also welcome to address related issues not included within the questions. The FDIC notes that, in soliciting comments on a possible revamping of the FDIC insurance coverage regulations, it is not questioning the legality of its current regulation. The agencies intend to consider all possible avenues available for remedying existing industry practices which may have a negative effect upon depository institutions and produce increased costs to the insurance funds as well as to the public. The questions are as follows:

1. Is the reduction in "market discipline" resulting from either brokerage activity or multiple insurance coverage of pension fund and other custodial deposits significant enough to warrant regulatory or legislative action? Why?
2. How should "deposit broker" and "deposit-brokerage activity" be defined?

3. Should the FDIC and the Board take any steps to limit the placement of deposits in insured institutions by a third-party intermediary? Why?
4. Should the FDIC and the Board amend their deposit insurance regulations to limit insurance coverage relative to deposits placed in an insured institution through any of the deposit-placement alternatives noted above or by any other method? Why and in what way?
5. Should the FDIC and the Board request that Congress amend the applicable provisions of the Federal Deposit Insurance Act (12 U.S.C. §§ 1811-31d) and the title IV of the National Housing Act (12 U.S.C. §§ 1724-30) to limit insurance coverage relative to deposits placed in an insured institution through any of the deposit-placement alternatives noted above or by any other method? Why and in what way?
6. Part 337 of the FDIC's regulations (12 CFR Part 337) prohibits certain prescribed activities which are deemed inherently unsafe or unsound banking practices. The Board similarly limits or prohibits certain transactions because they are potentially inconsistent with safe and sound operations. 12 CFR 563.34, 563.41, 563.43. Should the receipt of funds by an insured institution through a deposit-placement arrangement similar to the ones noted above be included within the prohibited activities in Part 337 and sections 563.34, 563.41, and 563.43? Why?
7. Alternatively, should the FDIC and the Board either prohibit or limit the receipt of brokered deposits only by institutions experiencing financial or managerial problems by deeming such a practice to be inherently unsafe or unsound? Why?
8. Should the FDIC and the Board impose special reporting requirements on: (1) institutions whose deposits consist of a significant percentage of funds placed through intermediaries and/or (2) institutions which are experiencing financial or managerial problems? Why? What should be deemed a significant amount?
9. Should the FDIC require that each bank involved in an FDIC-related enforcement action or memorandum of understanding on certain of the bank's activities obtain approval from the FDIC for deposits placed through intermediaries, and similarly, should the Board require each FSLIC-insured institution covered by a supervisory agreement to obtain such approval from the Board? Why?

10. Should the FDIC and the Board request that Congress enact legislation to require deposit-placement firms to register with the FDIC and the Board and/or report on a regular basis the institutions to which they are channeling investors' funds and the dollar amounts involved? Why?

11. Should the FDIC and the Board request that Congress enact legislation requiring brokers engaged in the placement of deposits at insured institutions to be registered with the Securities Exchange Commission? Why?

12. Should the FDIC and the Board request that Congress enact legislation requiring that the involved deposit-placement firm share part of the costs ultimately incurred by the insurance fund where funds have been placed with an institution within a specified time (e.g. thirty days) prior to the institution's failure for purposes of exploiting the deposit insurance system? Why?

13. To what extend would any of the proposed limitations or restrictions on deposit-brokerage activities affect the availability of funds for well-run institutions?

14. Should the FDIC and the Board take any steps to limit the multiple insurance coverage of deposits owned by more than one individual, such as pension-fund, trust, agency and escrow deposits? If so, should this be done by amending current FDIC and FSLIC regulations or by requesting that Congress amend the applicable provisions of the Federal Deposit Insurance Act (12 U.S.C. §§ 1811-31d) and title IV of the National Housing Act (12 U.S.C. §§ 1724-30)? Why? To what extent would this shift the risk of loss to the beneficiaries of such accounts as opposed to the fiduciaries?

15. To what extent has the placement of brokered funds been subject to a corresponding commitment to enter into a loan or other investment agreement with persons affiliated with or represented by a broker? Should such tie-ins be restricted or prohibited?

16. To what extent does the use of direct, nationwide advertising by insured institutions present problems similar to those arising from the acquisition of brokered funds? To what extent could such practices serve as substitute for raising funds through the use of brokers?

17. Should the Board require FSLIC-insured institutions to establish additional reserve for liabilities secured through brokers? Should such a requirement be limited to institutions whose net worth falls below a specified level?

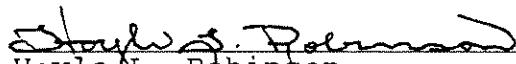
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18. Should the FDIC and the Board afford different treatment to short term (one year or less) and long term brokered deposits? Why?

19. What effect does the use of brokered funds have on the cost of funds of institutions which use them and on the cost of funds for institutions in general?

By order of the Board of Directors, October 24, 1983.

Federal Deposit Insurance Corporation


Hoyle L. Robinson
Executive Secretary

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By the Federal Home Loan Bank Board